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RR RUEHCHI RUEHCN RUEHDT RUEHHM
DE RUEHJA #2057/01 3110950
ZNR UUUUU ZZH
R 060950Z NOV 08
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 0562
RUEATRS/DEPT OF TREASURY WASHINGTON DC
INFO RUEHJS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC
RUEHKO/AMEMBASSY TOKYO 2692
RUEHBJ/AMEMBASSY BEIJING 5581
RUEHBY/AMEMBASSY CANBERRA 3251
RUEHUL/AMEMBASSY SEOUL 5094
RUEHGP/AMEMBASSY SINGAPORE 6368
RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 02 JAKARTA 002057

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS, EAP/EP AND EEB/IFD/OMA
TREASURY FOR IA/MALACHY NUGENT AND TRINA RAND
COMMERCE FOR 4430/KELLY
DEPT PASS FEDERAL RESERVE SAN FRANCISCO FOR CURRAN
DEPARTMENT PASS EXIM BANK
SINGAPORE FOR SBAKER
TOKYO FOR MGREWE
USDA/FAS/OA YOST, MILLER, JACKSON
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER
USDA/FAS/OGA CHAUDRY, DWYER
DEPT PASS USTR WEISEL, EHLERS

E.O. 12598: N/A

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SUBJECT: BANK INDONESIA MAINTAINS POLICY RATE AS GROWTH OUTLOOK
DETERIORATES

11. (SBU) Summary. Bank Indonesia (BI) held its overnight policy rate steady at 9.5% on November 6, in response to growing signs of a slowdown in economic activity in Indonesia. A moderation in inflation in October also contributed to the decision. While most market analysts expected BI to hold rates constant, some observers worry that higher rates will be necessary to discourage capital flight and support the value of the Rupiah (IDR). BI's official reserves fell \$6.5 billion to \$50.6 billion during the month of October, due in large part to foreign exchange market intervention. The Rupiah closed at 11,098 IDR/USD on November 6, according to BI. End Summary.

Signs of Slower Economic Activity Emerge

12. (SBU) BI held its policy rate constant on November 6, in response to growing signs of a slowdown in economic activity. Exports contracted 2.2% month-on-month (mom) in September as world demand and the price of Indonesian export commodities declined. Imports also contracted, falling 6.7% mom, due to lower world oil prices and slower domestic demand. Preliminary third quarter 2008 data from the manufacturing sector also point to a softening in economic activity. Growth in the manufacturing sector as a whole slowed to 1.6% yoy in the third quarter, down from 5.9% yoy and 3.3% in the first and second quarters, respectively. The sharpest declines occurred in the textile (30.6% yoy), machinery and equipment (17.3% yoy), and chemical (13.0% yoy) sectors. Anecdotal information from local bankers also points to significant tightening in USD credit funding for Indonesian firms in recent weeks, raising their funding costs and straining profits. Tigor Siahaan, Managing Director and Country Business Manager for Citibank Indonesia, also predicted new entrants to the palm oil sector would come under increased financial pressure, given declining values of their inventories and future harvests and limited cash flow. The Government of Indonesia will release official third quarter 2008 GDP figures on November 15.

Inflation Cools in October, but IDR Remains Weak

13. (U) BI also based its decision on moderating price trends. Consumer price increases eased in October, rising 0.45% mom. The yoy inflation rate fell to 11.8% from 12.1% in September. Food price increases also moderated in October, with mom food price inflation slowing to 0.71% compared with 1.9% in September. The yoy pace of food price inflation also fell, moving from 20.1% in September to 19.0% in October. Retail food prices for palm oil, rice, and soybeans have begun to fall, easing pressure on household incomes, according to local data collected by the Foreign Agricultural Service. Unbranded palm oil prices fell 6.4% during the month of October, while rice and soybean prices dropped 3.4%, and 4.1% over the same period. An Indonesian pancake vendor recently noted to the local press that this is the first time input prices have declined in the five years he has been in business. The price of chicken, eggs, flour and instant noodles have been slower to adjust, rising or falling only slightly during October 2008.

14. (SBU) While domestic sources of inflation have eased, BI's decision to hold rates constant may increase pressure on the IDR, raising the risk of imported inflation. The IDR/USD exchange rate continued to lose value in October as investor demand for IDR denominated assets declined. The IDR has depreciated roughly 16.2% during the past month, and is down 21.3% year to date. The depreciation in the IDR is generally in line with other currencies in the region year-to-date, although the IDR has declined more significantly than other currencies in recent weeks. BI continues to intervene actively in foreign currency markets to support the IDR, as indicated by the \$6.5 billion decline in official foreign currency reserves in October. BI's November 6 press release noted that the central bank intends to continue to intervene in the

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foreign exchange markets to prevent sharp fluctuations in the IDR. However, analysts note that BI's ability to control currency movements in the face of significant capital outflows is limited.

HUME